Has the Surgical Strike on Black Money Wrecked Our Economy?

The Narendra Modi government, which came to power in 2014 promising development for everyone, has arrested its own momentum in a major way with the note ban move. Our economy, after two years of severe drought, had barely started recovering following the normal rainfall this year and government aid when demonetisation arrived to throw a spanner in the works.

The decision on 8 November to render illegal 86% of Indian currency has without doubt put our economy in reverse gear, though no one has been able to calculate the exact extent of the damage yet.

Finance Minister Arun Jaitley is yet to make a statement on the impact of demonetisation on our GDP.

But Sadananda Gowda, Minister of Statistics and Programme Implementation, claims that it is likely to be hit by just 0.2%. According to the estimates provided by rating agencies and brokerage houses, however, it seems like it will be quite a while before the economy is able to recover from this sucker punch.

Prime Minister during the 'Jal Pujan' ceremony for the Chhatrapati Shivaji Memorial on Saturday. (Photo: PTI)

GDP: The Numbers Game

Credit rating agency Standard and Poor's Global states in its report that it expects India's annual growth rate in fiscal year 2016 to be 6.9% S&P lowered its growth forecast from an earlier estimate of 7.9% for the full fiscal year after the note ban decision. Fitch, another international ratings agency, similarly lowered the growth forecast from 7.4% to 6.9%; Goldman Sachs from 7.9% to 6.8%; and Ambit Capital from 6.8% to 3.5%.

The Worst is Yet to Come

Before the note ban, 90% of the country's transactions were cash-based. With the decision to freeze 86% of Indian currency, business crashed. Boston Consulting Group (BCG) and the Confederation of Indian Industries (CII) recently released a report which states that the actual impact of demonetisation on the economy can be properly assessed only in December-January.

According to a survey conducted by the two, industry growth rate fell to 4% in November. That the number is not even lower is only thanks to order backlogs. It also shows that the total sales number in the auto sector fell by 5%, while the building material segment also saw growth shrink by 1%.

Keeping in mind the current situation, some auto companies have temporarily stopped production, though the ostensible reason they cite is plant maintenance. Even the service sector, which makes up 60% of the GDP, has taken a severe hit, with its Purchasing Manager's Index (PMI) slipping into the negative zone.

The Informal Sector

The informal sector, which contributes 45% to the GDP, is completely cash-dependent and therefore the worst affected due to demonetisation of 500 and 1,000 rupee notes. This sector accounts for about 80% of employment and the units that fall under it have been unable to pay salaries due to the cash crunch. As a result, many informal sector labourers and workers have been forced to return to their villages.

The currency crunch has negatively affected the world of exports as well, with the trade deficit (excess of imports over exports) in November reaching the highest it has been in 16 months. This is bound to affect employment negatively, with many jobs getting slashed in an economy that is already infamous for jobless growth.

Bank's Loan Growth Hit

Economic indicators like bank loans present an even more terrifying picture. Bank's loan growth is the weakest it has been in 19 years. Banks have invested all their energies in the last 45 days in dealing with consumer deposits and dispensing cash, with other functions taking a back seat.

According to brokerage firm Jefferies, Indian bank's loan growth will fall to 6% in this fiscal year, the lowest it has been since 1962. This figure in fiscal year 2015 was 10.9%.

Market Watch

The note ban has also had severe repercussions for the stock market and negatively impacted foreign investor behaviour.

In November alone, foreign investors sold nearly $3 billion worth of Indian stocks. Among those hit by this move are fast-moving consumer goods companies like ITC, HUL, and Nestle, as well as consumer durable companies like Voltas and Whirlpool. Since 8 November, investors of consumer goods stocks have suffered losses to the tune of Rs 1.2 lakh crore.

Sectors like realty, auto, NBFC and cement are possibly worse off. Foreign investors will likely continue exercising caution with respect to India since the profit growth of companies is directly tied to GDP growth, which is not expected to recover before the September-December quarter next year.

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